Before the Michigan House Energy & Technology Committee

Regarding House Bill 5895

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Mr. Chairman, honorable members of the Committee, I am Rick Cimerman, Vice-President State Government Affairs of the National Cable & Telecommunications Association ("NCTA") which is the principal trade association representing the cable industry in the United States. Its members include cable operators serving more than 90% of the nation's cable television subscribers, as well as more than 200 cable programming networks. NCTA's members also include suppliers of equipment and services to the cable industry. The cable industry is the nation's largest broadband provider of high speed Internet access after investing $100 billion over ten years to build out a two-way interactive network with fiber optic technology. Cable companies also provide state-of-the-art digital telephone service to millions of American consumers.

I'm here today to discuss video franchising reform and House Bill 5895 (HB5895). I will provide information on some of the federal activity surrounding video franchising, activity in other states, and I will make a few observations about video franchising and AT&T that I trust will be useful in your deliberations.

Introduction

At the federal level there is video franchising activity in both Houses of Congress as well as the FCC. A bill known as the Communications Opportunity Promotion and Enhancement (COPE) Act (HR 5252) has passed out of the House Energy and Commerce Committee and is awaiting floor action. In the Senate, the Communications, Choice and Broadband Deployment Act of 2006 (S 2686) takes a somewhat different approach to reforming the video franchising regime. It is currently the subject of committee hearings, with a markup scheduled towards the end of June. In addition, the Federal Communications Commission (FCC) has at least two proceedings underway that could impact video franchising. This substantial federal activity begs the question of whether there is a need for state action at this time.

In terms of state activity, as most of you probably know, the State of Texas enacted a video franchising statute last year. It is currently the subject of both federal and state lawsuits because it violates the Constitution and federal law. HB5895 suffers from many of the same infirmities.

Several other states have passed video franchise legislation this year: Indiana, Virginia, Kansas, and South Carolina. New Jersey is poised to do so as well. All of them differ markedly from the Texas bill, most importantly because, in one form or another, they treat like services alike.

In my testimony I address the federal activity and make the following points:

- The law does not need to be changed to allow AT&T to enter the already competitive video marketplace;
- Claims regarding the economic impact of telco video entry on consumers are wildly overstated;
- Third party groups should disclose their sources of funding;
- AT&T is not a new entrant that needs a regulatory leg-up;
- Local franchising is not a barrier to entry;
- There are important social responsibilities attendant to offering video services; and,
- AT&T is forum shopping, looking for any venue that will allow them to avoid these social responsibilities.

In addition, I'd be happy to answer any questions about state activity.

There is no need for Michigan to take action on video franchising while various federal activities play out:

In Congress, both the House and Senate are contemplating legislation that would change today's video franchising system. HR 5252 has passed out of the House Energy and Commerce Committee and is expected to reach the floor within the next several weeks. It would:

- Allow new entrants to obtain national franchises to provide video service;
- Require national franchisees to identify each "franchise area" in which they intend to offer cable service;
- Define the "franchise area" as either the entire franchise area of an existing cable operator or the entire geographic area of the unit of general local government where the person or group intends to offer service (this is especially important as it defines the area over which potentially discriminatory deployment may be measured);
- Establish a 10 year term with automatic renewal for national franchisees;
- Allow an incumbent cable operator to obtain a national franchise for a franchise area in which there is a competing wireline entrant;

- Allow franchise fees of up to 5 percent of gross revenues, with the exact level determined by the local franchising authority;
- Amend the definition of gross revenues to include, *e.g.*, all advertising revenues of a cable operator;
- Require a national franchisee to dedicate channel capacity for PEG programming that is not less than the channel capacity required of the largest cable operator in that area on the date of enactment; and
- Allow LFAs to collect up to an additional 1 percent of gross revenues from national franchisees for support of PEG and institutional networks.

The proposed Senate legislation, S 2686, takes a somewhat different tack. One hearing has been held and two more are expected. A mark-up is expected in the latter half of June. The primary differences between S 2686 and HR 5252 are that the Senate bill:

- Leaves franchising at the State/local level;
- Establishes a 30-day shot clock for franchises and renewals using a new FCC-prescribed standard franchise agreement form in which a local franchising authority is responsible only for prescribing

franchise fee, number of PEG channels, PEG/INET support fee, and a point of contact;

- Allows that if a franchising authority fails to act on an application within a 30-day time period the franchise is deemed granted for 15 years;
- A franchising authority can set the term of franchise, but no less than five years or longer than 15 years;
- Extends existing prohibitions on income-based discrimination to prohibit discrimination on the basis of race or religion, to be enforced by the FCC through complaint-initiated adjudications; a complaint may be filed by aggrieved resident or by a franchising authority.

The FCC, for their part, has several proceedings underway in which video franchising issues have been raised. In a Notice or Proposed Rulemaking (NPRM) entitled *Rulemaking on Ensuring Reasonable Franchising Process for New Video Market Entrants* the FCC is examining its role with regard to Section 621(a)(1) of the Communications Act. That section states in part that "a franchising authority … may not unreasonably refuse to award an additional competitive franchise." Notwithstanding a complete lack of evidence of any unreasonable denials of franchises, the FCC is considering its options.

In a proceeding known as the IP-Enabled Services proceeding, AT&T has asked the FCC to rule that its proposed video technology is not a cable service under the Communications Act and therefore does not require a franchise. We disagree with AT&T's position, but the issue is squarely before the Commission. Given all of this activity it seems premature to enact new legislation at the state level.

The telephone companies have had a decade to enter the video market - the law does not need to be changed to allow AT&T to enter this already competitive marketplace:

In 1996 when Congress lifted the ban on telephone entry into the video business, it was a significant change in federal telecommunications policy. For decades, Congress kept the telephone companies out of the video business for fear that their monopoly control over the local phone market would allow them to exert market power in a way that would harm video competition. This threat was based on the telephone companies' anticompetitive behavior regarding pole attachments and their incentive and ability to shift costs associated with video service into their regulated telephone rate base and thereby unfairly cross-subsidize their entry into the video business with revenues from their telephone monopoly.

However, Congress lifted the ban in 1996 largely because the '96 Telecommunications Act also established rules to promote competition in the local voice market. Congress hoped that such competition would inhibit the ability of the Bells to use their telephone monopoly to enter the video marketplace in an anticompetitive manner.

The '96 Act gave the phone companies four options for entering the video business and expressly stated that if they chose to enter as a cable system, they would be subject to the same requirements of Title VI as any other cable operator. At that time, the telephone companies didn't complain that the local franchising process was a barrier to entry and Congress chose not to eliminate for telephone companies that chose to enter the cable business, any of the traditional requirements that apply to cable operators, whether they were first to the market or last. To the contrary, recognizing that large incumbent telephone companies were fully capable of competing vigorously in the video marketplace, Congress stipulated that cable operators would be free from any remaining rate regulation whenever a telephone company entered an operator's franchise area.

Now a decade later, having made little effort to enter the video business, the phone companies are back claiming that they need special rules that would allow them to enter the video marketplace in a manner that would give them a regulatory advantage over their competitors. It is remarkable that the Michigan legislature or Congress would even entertain the Bells new pleas for special favors when the very rationale for allowing the Bell companies to enter the video business in the first place has yet to materialize—competition in the local voice market. Rather than spending the last ten years offering video competition, as they promised, they have invested their time and tremendous financial resources in the courts, at state Public Service Commissions, and at the FCC attempting to frustrate Congressional efforts to promote voice competition. They have successfully crushed most of their local voice competitors and swallowed their long distance competition. Ten years after the passage of the 1996 Telecom Act, the incumbent telephone companies still have a vice grip on 85% of the local telephone marketplace.

Meanwhile, during those same ten years, competition to cable operators has increased dramatically, most notably through the presence of two large DBS operators. In stark contrast to the behavior of the Bell companies, the cable industry responded to the deregulation of the 1996 Telecom Act and vibrant competition by investing $100 billion in private risk capital (as opposed to the telephone network built with a government guaranteed rate of return) to upgrade its facilities with state of the art fiber optic technology. The industry made this investment without government subsidies and with no guarantee of a return on its investment.

And just as it created a multichannel video service from scratch, cable pioneered the residential broadband marketplace, while the telephone companies kept DSL technology on the shelf in order to preserve their high-priced T1 business service. Cable's innovation and risk-taking made cable the nation's leading broadband provider of high-speed Internet access.

Claims that telco entry into video will result in huge consumer welfare gains are vastly overstated:

Bell telephone companies have recently funded several "studies" that purport to show that video franchise reform will result in huge consumer welfare gains. These "studies" are flawed in several ways. Key among these flaws is that they: 1) assume that telcos will offer video services to all U.S. households – which even the telcos themselves don't claim is likely; 2) assume they begin offering video service as soon as they receive their franchises – which the evidence shows to be otherwise; 3) assume that telcos don't apply for franchises until they have completed building their plant; and 4) assert that substantial price competition will take place.

On this last point it's important to note that the telcos themselves, including AT&T, are making clear that price competition is not the likely result of their entry. AT&T and Verizon officials have recently been quoted making the following statements:

- Richard Lindner, CFO, AT&T said in late April that Project Lightspeed IPTV services will probably be priced somewhat *higher* than the average cable TV subscription.
- Jeff Weber, VP Product and Strategy, AT&T is reported to have "demurred on the topic of commercial pricing [of AT&T's cable service] but said that AT&T believes it will offer a better product than its competitors so 'we don't have to be the low-price guy in the market.'"

- Bruce Byrd, VP-General Counsel, AT&T is reported as stating that "our business plan is not built around extreme price cuts." He called AT&T's IPTV "a high-end service" so "our model has not been slash and burn prices."
- And Verizon also apparently shares AT&T's view that competition need not result in lower prices for its products. Thomas McGuire, Director-Federal Public Affairs, Verizon, said Verizon will price its FiOS service "competitively, but not at a discount" since it's "worth somewhat more than cable."

Accordingly, I would urge care in relying on price competition by telcos as the public policy justification for video franchise reform. There may be other competitive features and benefits of telco entry into video. But for AT&T and Verizon at least, undercutting the prices of cable operators does not appear to be one of them.

Third party groups should disclose their sources of funding:

In discussing some of this telco-funded research I wanted to briefly mention third party groups and one of the major differences among some of them. That is disclosure. I don't know whether you're familiar with Broadband

Everywhere. It is a bipartisan organization devoted to promoting the broadest deployment of competitive broadband networks. Broadband Everywhere's founding organizations are the American Cable Association (ACA) and nearly 15 small cable operators, the Hispanic Federation, the National Congress of Black Women, and the National Cable & Telecommunications Association (NCTA). I want to be explicit that Broadband Everywhere has received financial support from NCTA and expects to receive additional support from NCTA, ACA and other sources. Disclosure - that's the major difference. We challenge other advocacy organizations to disclose their financial relationships as well.

I raise this point for a reason. I know there are a number of organizations weighing in on video franchising that claim to represent consumers or other interests, but in fact receive substantial funding from telephone companies or their surrogates and are not the independent voices they purport to be. These include Consumers for Cable Choice, the Internet Innovation Alliance, the American Consumer Institute, and the Phoenix Center among others. Even those that claim they don't receive funding directly from telcos often receive funding through a network of pubic relations and lobbying firms that are ultimately funded by the telcos. I urge you to ask any such groups to disclose their funding sources so that you may determine for yourself any sources of bias.

AT&T is not a new entrant that needs a regulatory leg-up -

AT&T has a number of advantages over traditional new entrants, and even over existing cable operators. Unlike traditional new entrants, AT&T already has connections to virtually every home (and business) within their service territory. They have facilities in the rights-of-way and in some cases the power of eminent domain and access to private easements. These facilities were built with a government guaranteed rate of return, and in some cases through universal service subsidies. And their financial strength dwarfs that of any typical new entrant, or even cable companies. AT&T alone (just one of the four Regional Bell Operating Companies) has a market capitalization of $81 billion compared to a market cap of $112 billon for the top ten cable operators combined. Their annual revenues of $41 billion equal two-thirds of the annual revenues of the entire cable industry. On top of that they recently announced their intention to spend $67 billion to purchase BellSouth. The idea that they need government assistance to compete is disingenuous at best.

Local franchising is not a barrier to entry -

Telcos can and do obtain franchises. During the late 1990s, when Ameritech, now part of AT&T, decided to avail itself of the 1996 Act's opportunities to provide in-region cable service, franchises were obtained for 111 communities. Ameritech did not express frustration with the franchising process then. And it operated under Title VI for several years before deciding to exit the video business. BellSouth received at least 20 franchises in the 1990s, representing 1.4 million potential cable households. And in the last several months, Verizon has been awarded franchises in numerous communities in California, Florida, Maryland, Massachusetts, New York, Pennsylvania, Texas and Virginia representing over 2 million potential subscribers. It is negotiating with at least 250 additional cities and municipalities. It's hard to believe, as AT&T likes to claim, that a company with their regulatory prowess and manpower cannot reach satisfactory agreements with local franchising authorities (LFAs) in a reasonable time period.

As you've heard today, LFAs seek to encourage additional video entrants. As we noted in comments to the FCC, hospitality, not hostility, awaits new entrants on the steps of city hall. In any case, complaints about the time it takes to negotiate a franchise ring somewhat hollow in light of the ability of companies like TCI, AT&T (in a former life), Charter, Comcast, Adelphia, and Time Warner to complete thousands of transfer approvals with LFAs in the matter of a few months in major merger cases.

AT&T should acknowledge there are important social responsibilities attendant to offering video services, including non-discrimination – Wireline video service providers have long had several important social responsibilities. These include making service available to *all* residents, regardless of income; meeting the local information needs of the communities they serve; and, complying with consumer protection obligations. HB5895 falls short in all these areas, particularly with respect to non-discrimination.

AT&T is forum shopping, making different arguments in each venue - At the state level AT&T is arguing for state franchising. At the federal level AT&T is arguing for national franchising. In both cases, AT&T wants to limit the role of local government. AT&T is asking state legislatures to give the states control and preempt local governments, even as they go to Washington and ask Congress to preempt both the states and local governments. As if that's not enough, they're telling the FCC that their existing telecom rights-of-way authority, coupled with their technology that they claim is so new and utterly amazing, means that they don't need franchises at all. When they make the same argument to cities, if the cities don't acquiesce and allow them to build facilities and offer service without a franchise, they sue the cities. So far they've filed suit against cities and towns in at least California and Illinois and perhaps elsewhere.

Of course, few have fallen for their argument that their technology entitles them to bypass the franchising process - when they claimed their IPTV service did not require a franchise in the context of HR 5252 in the House Energy and Commerce Committee, Chairman Barton called the argument "stupido" and Congressman Dingell requested a response to the question of why the bill should even be considered if companies could self-define themselves out of its terms.

So pardon me if I'm a little confused and if I don't know exactly what AT&T wants. Do they want the states do preempt municipalities? Do they want the feds to preempt states and municipalities? Do they want to sue the municipalities into submission? I guess it's a little unclear what they want – except that it's clearly anti-municipality.

So what's our view? Our view is that and needed franchise reform should take place at the national level. Our view is that AT&T should step up to the plate and acknowledge there are important social responsibilities, including non-discrimination that have long been the hallmark of video regulation. And finally, our view is that any effort to change the system must treat like services alike and respect localism.

Thank You, Mr. Chairman and honorable members of the Committee for the opportunity to speak with you today. I look forward to your questions.